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TREASURY FOR OTA-MCDONALD, IA-BAUKOL  
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DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR TCURRAN  
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SUBJECT: INDONESIA - FINANCE MINISTER'S DRAMATIC TAX REFORMS

¶1. (SBU) Summary: Finance Minister Mulyani's reform efforts are achieving dramatic, substantive improvements at the Directorate General for Tax (DG Tax), formerly one of the most corrupt government agencies in Indonesia. Reforms of business process, codes of conduct, internal controls and data processing are moving from rapidly from plans to implementation. USG advisors are welcomed and having a positive impact. Embassy recommends the continuation of assistance to DG Tax through at least 2009 (see paragraph 10), which is also supported by the GOI. End Summary.

Finance Minister Leads the Way  
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¶2. (SBU) Finance Minister Mulyani, easily the most dynamic reformer in the Government of Indonesia (GOI), has been using bilateral and multilateral assistance strategically to assist in her internal reforms at the Ministry of Finance. Key directorates, formerly plagued by corruption, incompetence or both, are being cleaned up. These include the important directorates of tax, customs, capital markets supervision, insurance regulation, debt management, and others. The Directorate General for Tax (DG Tax) is undergoing one of the most remarkable changes in the entire Government of Indonesia.

DG Tax: From "License to Extort"...

¶3. (SBU) Within less than a month of taking up her new post as Finance Minister in December 2005, Mulyani asked major donors for help with tax reform. The previous Director General for Tax was notorious and tax problems were one of the most frequent complaints by the international and domestic business community. Indeed, one European Embassy described DG Tax in early 2005 as having a "license to extort." Recognizing the need for both symbolic and substantive changes, Mulyani urged donors to support her: "I want the best brains in the world to help me succeed in reforming DG Tax. I want to restore trust," she said.

...to "Transparency and Honesty"  
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14. (SBU) DG Tax, which was previously a fairly grim, corruption-ridden agency, is now buzzing with new energy and enthusiasm since Mulyani's new Director General Darmin Nasution was appointed in mid-2005. Donors have been pouring in the help, coordinated by the International Monetary Fund (IMF). USAID and the U.S. Treasury's Office of Technical Assistance (OTA) responded with advisors. USAID provided technical support for the development and implementation of the internal compliance and internal investigation sub-directorates. Both sub-directorates are now operational and leading to significant positive reforms. The internal Codes of Conduct are now well known throughout the organization, and tax officials even have bright yellow-and-blue buttons that read, "Transparency and Honesty."

#### Most Dynamic Reform of 20 Countries

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15. (SBU) IMF Senior Tax Advisor Rick Fisher remarked that in all the 20 countries he has worked in, Indonesia's tax overhaul is the "most dynamic reform effort I have ever seen. We are at that exciting turning point where tax officials are implementing what used to be theoretical recommendations, and taking ownership." Fisher emphasized the importance of not losing momentum. "Time is running out before 2009 elections. We have to push through as many reforms as possible, but without overwhelming DG Tax's capacity for absorbing it all. So far, we've got a good balance." The main thing is, Fisher noted, that Mulyani has to show the Parliament (DPR) that she is getting results in terms of increased revenues. Without that, she may lose DPR support for her efforts.

#### Increasing Efficiency and Internal Controls

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16. (SBU) A number of early audits and investigations in 2005 and

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2006, including investigation on money laundering, have resulted in changes to DG Tax databases and systems, and serious disciplinary action against several DG Tax staff members. Previously, there was no access control to tax databases, meaning any official could alter a file in response to a bribe. Now within the DG Tax office, there is a new USAID-supported Directorate for Intelligence and Investigation. This is the first government department devoted entirely to the identification and investigation of major criminal tax offenders. We expect that significant gains will be realized in overall tax compliance and in tax revenues in the near-to-medium term from this change.

#### Momentum Continues on Data Processing Center

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17. (U) Treasury's Office of Technical Assistance Advisor David Gaugler has been working with DG Tax on a Data Processing Center to improve the efficiency of tax return filing in Indonesia. Previously, a majority of returns submitted were not processed in a timely manner. To date, it has most of the building blocks in place, including the signed Ministerial Regulation, an IT support contract, a Human Resources (HR) contract, and a mostly completed facility. The first simulation exercise begins in December, and the first practice with real documents in January 2008. As part of phased implementation, Gaugler expects by February the project will be expanded to an entire tax office, by March to eight offices, and by the end of 2008 to all agents, offices and documents (VAT, individual income, corporate and land tax) in the greater Jakarta area.

18. (SBU) Gaugler notes that a good, comprehensive business model for reform is now in place, which he has "never before experienced in any other country." Additional tasks include finalizing procedures and training manuals, workload forecasts, sequential contract employee accession plans to staff the DPC, and tax office training schedules. After this pilot project, the DGT plans to implement more DPCs throughout Indonesia.

#### Public Affairs Assistance Needed

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19. (SBU) DG Tax advisors, in a December 6 meeting with the Embassy, also feel strongly that DG Tax needs a public affairs strategy. With 170 Small Taxpayer Officers (STOs) set up in 2007, and another 120 planned for 2008 (along with Large and Medium Taxpayer Offices already established), DG Tax is undergoing so many changes so rapidly, that not everyone is keeping up, even internally. Education and communication of DG Tax staff about the direction and new expectations of the agency are essential. Even the DPC is a well-guarded secret, Fisher noted. "It will be hard to implement new procedures without a public outreach strategy."

Extended Treasury OTA Assistance Requested  
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10. (SBU) The Embassy requests that Treasury OTA seriously consider funding ongoing assistance to DG Tax at least through Phase 3 in 2009 (complete report sent separately to Treasury OTA). This is also strongly supported by DG Tax officials, who note that, "The transition period between the pilot and full implementation will be much more difficult without the presence of the advisor. We would like the advisor to continue to help through the implementation phases." OTA Assistance to the Data Processing Center is expected to continue on the following implementation schedule, steadily expanding VAT, income tax and withholding tax processing to more and more offices:

- Phase 2: Early-2009
- Phase 3: Mid-2009
- Phase 4: Early 2010

In addition, Embassy recommends that additional assistance to DG Tax in the area of public affairs, both for internal communication between DG Tax offices, and outreach to the public.

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